No. 8363

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

OLIVE LEMM, Individually, and as Administratrix of the Estate of Charles Lemm, Deceased,

Appellant,

vs.

NORTHERN CALIFORNIA NATIONAL BANK, THE REDDING SAVINGS BANK and CARR AND KENNEDY (a copartnership),

Appellees.

BRIEF FOR APPELLEES.

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BRIEF FOR APPELLEES.

JURISDICTION.

The United States District Courts are invested with original jurisdiction in bankruptcy proceedings and are the "courts of bankruptcy" defined in the Act.

Bankruptcy Act (U. S. Code, Title 11, Chap. 2, Sec. 11).

The dismissal of proceedings filed under the provisions of Section (75(a-r) of the Bankruptcy Act is within the recognized jurisdiction of the District Courts.

In re Borgelt, 79 Fed. (2d) 929;

Steverson v. Clark, 86 Fed. (2d) 330;

In re Tinkoff, 85 Fed. (2d) 305;
In re Augustyn, 87 Fed. (2d) 577.

The filing of a petition for an agricultural composition and extension immediately subjects the farmer and all his property to the exclusive jurisdiction of the court.

Bankruptcy Act, Sec. 75(n);
In re O'Brien, 78 Fed. (2d) 715;
Harris v. Pacific Mutual, 91 Cal. Dec. 813;
In re Morgan, 15 Fed. Supp. 52.

The filing of a petition for relief under the provisions of Bankruptcy Act relating to agricultural compositions and extensions is equivalent of adjudication in bankruptcy.

In re Rose, 86 Fed. (2d) 69.

Rules of equity applicable to bankruptcy proceedings.

In the administration of the Bankruptcy Act, the bankruptcy court is a court of equity, and is governed by equitable doctrines.

Greif Bros. etc. Co. v. Mullinix, 264 Fed. 391;
In re Fox West Coast Theaters, 88 Fed. (2d) 212;
In re Alabama Braid Corp., 13 Fed. Supp. 336;
Nat'l Cash Reg. Co. v. Dallen, 76 Fed. (2d) 867;
Gilbert's Collier on Bankruptcy, 3rd ed., Sec. 23.

APPELLEES' STATEMENT OF THE CASE.

Appeal from order of the District Court granting motion of creditors, appellees, for dismissal of petition filed by debtor, appellant, under provisions of Section 75(a-r) of Bankruptcy Act, after the termination of prior proceedings taken by appellant under Section 75(a-r) and Section 75(s) of the Act.

In view of the fact that some of the essential facts of the case are not disclosed in the statement of the case contained in Appellant's Opening Brief, and the fact that appellees controvert parts of said statement, it should be helpful to the court, and perhaps shorten the argument, if we give here a complete statement of the facts of the case.

During November, 1935, appellant filed a petition under Section 75(a-r) of the Bankruptcy Act, numbered 6575, seeking to effect a composition or extension of her debts. The petition was filed by appellant Olive Lemm individually, and as Administratrix of the estate of Charles L. Lemm, her deceased husband. (Transcript, pages 17-18.) The schedules filed with said petition showed that petitioner's assets, valued at $28,529.00, exceeded her liabilities, listed as $23,582.76. (Transcript, pages 19-23.)

A proposal of composition with creditors (patently unreasonable), having failed of acceptance, appellant filed a motion for the dismissal of said "proceedings for a composition or extension" (Transcript, pages 12-13), and subsequently filed a petition to be adjudged a bankrupt in accordance with Section 75(s) of the Bankruptcy Act.

On June 15, 1936, in the District Court, the debtor's motion to dismiss her proceedings under Section 75(a-r) was granted, and then a motion for the dismissal of the debtor's petition under Section 75(s), previously filed by the creditors, was granted. As a matter of fact, counsel for appellant stipulated in open court for the entry of the latter dismissal, though such consent was not recorded in the clerk's minutes. (Transcript, pages 14-15.)*

Prior to June 15, 1936, the date of dismissal of the foregoing proceedings, and without the knowledge or leave of the court, the appellant paid in full the claims of some of the creditors named in her schedule of liabilities, using for said purpose some of the funds listed in her schedule of assets. (Transcript, page 15.)

This fact was not only shown, without dispute, by the affidavit filed in support of the creditors' motion to dismiss appellant's second petition for composition, but it is demonstrated by a comparison of the schedules filed by appellant with her respective petitions.

The schedule of assets filed with her first petition included the item "Cash.....$5000.00". (Transcript, page 23.)

The schedule of liabilities included the following claims:

*The order of May 28, 1936, mentioned in the minutes of June 15, was an order Judge Roche had made granting a motion by the creditors to dismiss the original proceeding under Section 75(a-r) for the absence of good faith in the proposal for composition. It was set aside, over the creditor's objection, so that appellant's counsel could present her motion for dismissal which had previously been filed by appellant.

"Open Book Account with McCormick Saeltzer Co. $251.86
Open Book Account with Dr. F. Stabel 455.00
Open Book Account with McDonald & Scott 273.50"
(Transcript, page 20.)

The schedule of assets filed with appellant's second petition (Transcript, page 8) shows cash in the sum of $2156.65, and the above claims are omitted from the schedule of liabilities. (Transcript, pages 4-5.)

As the claims which were paid aggregated $980.36, and the cash on hand was reduced from $5000.00 to $2156.65, the additional sum of $1862.99 which was subject to the jurisdiction of the bankruptcy court, remains unaccounted for.

The fact that appellant disbursed said funds and paid said claims before the entry of the order of June 15 appeared undisputably from the fact, shown by the record here, that her second petition under Section 75(a-r), showing said facts, was verified by appellant on the *12th day of June, 1936,* i. e., before the first proceedings were terminated. (Transcript, page 3.)

The second proceeding, No. 6935.

On June 22, 1936, appellant filed her second petition and schedules under Section 75(a-r). Said petition was filed by appellant individually, and as administratrix of the estate of her deceased husband, and, as in the case of her first petition, it was alleged that all the property therein set forth was the property of petitioner and the deceased. (Transcript, page 2.)

Appellees thereupon served and filed a motion for the dismissal of said proceeding (Transcript, pages 9-11), supported by the affidavit of Laurence J. Kennedy, one of appellees' counsel. (Transcript, pages 12-16.)

At the hearing of said motion there was no contradiction of said affidavit or of any fact therein averred and the motion was presented, argued and submitted in the District Court upon all the records of the court in said bankruptcy proceedings, numbers 6575 and 6935.

Said motion was granted and the proceedings dismissed by an order made in the District Court by Honorable Michael J. Roche, District Judge, on September 22, 1936. Said order is set forth *in haec verba* in the printed transcript, page 17.

We beg leave, here, to controvert the statement made in appellant's statement of the case (page 3) that said proceedings "were dismissed upon the ground that the former proceedings, number 6575, constituted a bar to appellant's subsequent attempt to reach a composition or extension agreement with her creditors".

There is nothing in the order to substantiate said conclusion of counsel, and it may be attributed to the fact that counsel for appellant who prepared the brief did not appear in the court below, and did not hear the oral comments of Judge Roche at the time the motion was argued.

During the argument in the District Court, in which the several grounds of dismissal raised by the motion

were discussed, the court expressed severe condemnation of appellant's conduct in disbursing funds and paying some of her creditors in full. Then, at the request of counsel for appellant, leave to file briefs was granted, and the major discussion in the briefs was in relation to appellees' claim of lack of good faith as raised in paragraph 4 of their motion.

Thus, although we urged, with authority, that the *dismissal* of the prior proceedings constituted a bar to the second petition, there is nothing in the record to support the claim of counsel that the court's order dismissing the second proceeding was made solely upon that ground, for, judging from the court's remarks, it may have been based upon the ground of lack of good faith on the part of the debtor, and the order may be sustained upon any meritorious ground specified in the motion.

The interests of appellees.

The Redding Savings Bank is the holder of trust deeds upon two of appellant's farms, the same being the two tracts of real property described on page 6 of the transcript. According to appellant's petition, the aggregate value of said properties is $8600.00 (Transcript, page 6) whereas the aggregate indebtedness secured by the trust deeds, as shown by the petition, was something over $19,000.00 in February, 1936 (Transcript, page 4); and more than a year's interest has since accrued.

The Northern California National Bank and Carr & Kennedy are creditors of the estate of Charles Lemm, holding unsecured claims, which have been approved by the Probate Court. (Transcript, pages 4-5.)

THE ASSIGNMENTS OF ERROR.

In appellant's opening brief counsel for appellant announce that on this appeal they rely upon assignments of error, 4, 5, 6 and 8. Therefore it should be unnecessary for appellees to take notice of any other assignment of error, but it seems appropriate here that we call the court's attention to a serious misstatement of the record contained in the transcript, in the 7th assignment of error, to the effect that the District Court decided in favor of appellant in its ruling upon appellees' claim, in the motion to dismiss, that the petition was not filed in good faith but was filed for the purpose of delaying and hindering her creditors.

This erroneous statement may doubtless be attributed to the fact, mentioned in our opening statement, that the author of the brief did not appear in the lower court.

There is nothing in the record to justify said statement, but the fact is that at the close of the argument on this motion, when he ordered the matter submitted, the district judge expressed from the bench in very positive language his disapproval of the conduct of the debtor during the original proceedings, particularly the payment of some of her creditors in full before she had filed her petition under Section 75(s).

ARGUMENT.

On this appeal the issue is not limited to the question stated in appellant's opening brief, but we believe it may properly be said that the question raised by the appeal is whether or not appellees' motion to dismiss appellant's second petition under Section 75(a-r) was properly granted upon any of the grounds presented in the District Court.

In support of the ruling of the lower court we shall present the matter under three heads.

I.

THE ORDER GRANTING THE MOTION AND DISMISSING APPELLANT'S PETITION WAS PROPERLY MADE BY THE DISTRICT COURT UPON THE GROUND THAT THE FORMER PROCEEDINGS UNDER SECTION 75(a-r) AND SECTION 75(s) AND THE DISMISSAL THEREOF WERE A BAR TO THE FILING OF A SECOND PETITION.

This topic embraces three of the grounds for dismissal specified in appellees' motion, set forth in paragraphs 1, 2 and 3 of the motion (Transcript, page 10), viz.:

> That the second petition was filed without authority of law;
>
> That the dismissal of the proceedings taken by appellant under Section 75(a-r) and Section 75(s) constituted a bar to the second petition under Section 75(a-r);
>
> That the District Court lacked jurisdiction to entertain the second petition.

The order dismissing the second petition upon said grounds is directly supported by the decision in the case of

In re Archibald, 14 Fed. Supp. 437.

In that case, as here, the original petition under Section 75(a-r) was dismissed on motion of the debtor on the ground that no composition or extension had been reached, which was held sufficient to bar the second petition.

Here we have the additional feature that the debtor also filed a petition under Section 75(s), and that same was dismissed on the adversary motion of the creditors, with appellant's consent, after she had urged and obtained the dismissal of her first petition under Section 75(a-r).

The argument of counsel that, as a matter of policy, the Act should be construed to allow successive petitions under Section 75(a-r) according to changes in general economic conditions, is not impressive.

Counsel say:

> "It is entirely possible that at one particular time, possibly during a period of financial stress, an amicable agreement between a debtor and her creditors could not be reached, while at a later time under improved financial conditions such an agreement would be possible."
>
> (Appellant's Opening Brief, page 5.)

Said proposal suggests the question: What are the creditors expected to do during the interval between the abandonment of the first petition and the filing of

the second? Are some of the creditors to be paid, and the others delayed by the second proceeding?

Further, the reasoning of counsel is not pertinent in the present case.

It is obvious that the second petition was not prompted by a change of circumstances or economic conditions in the interval between the two proceedings, but the record shows that the second petition was actually prepared and verified by appellant before the termination of the proceedings under the first petition.

There was a change, it is true, in the debtor's circumstances, namely, she had paid some of her unsecured creditors in full, without regard to the like claims of the appellees; and having done this, it was planned to again suspend the enforcement of appellees' claims invoking the statute.*

However, having used some of the funds and paid some of the creditors listed in the schedules filed with her first petition, for which appellant would be answerable to the bankruptcy court in her proceedings under Section 75(s), she asked for the dismissal of her first petition and consented to dismissal of the petition filed under Section 75(s), when the new petition was ready, so her plan could be put into operation.

The language of the court in the case of *In re Archibald,* supra, is apposite:

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*The filing of the second petition was timed to effect a stay of a trustee's sale under the deeds of trust held by the appellee savings bank; and in a second proposal for composition, presented after the motion to dismiss the second petition was served and filed, the debtor offered her remaining unsecured creditors 66⅔% of their claims. (Transcript, page 30.)

> "The effect of filing such petition and application is to suspend, for the time being, the right of any creditors to enforce his claim.
>
> "If, upon the failure of a proceeding, the judgment of dismissal, the farmer-debtor may commence a second proceeding against the same creditors and again suspend the enforcement of all claims against him, there is no reason why he could not, upon failure of the second proceeding, commence a third proceeding, and so on ad infinitum, and thus indefinitely prevent his creditors from enforcing their claims against him."
>
> (Opinion, p. 439.)

The statute expressly provides what shall be done in case a farmer fails to obtain the acceptance of a proposal for composition or extension and there is nothing in the Act to justify a change in procedure at the election of the debtor.

Section 75(s) provides:

> "Any farmer failing to obtain the acceptance of a majority in number and amount of all creditors whose claims are affected by a composition and/or extension proposal, or if he feels aggrieved by the composition and/or extension, may amend his petition or answer, asking to be adjudged a bankrupt."

That is very different from saying, as counsel contend, that any farmer failing to obtain the acceptance of his proposal for composition, may dismiss his petition for a composition or extension and later, when it may suit his fancy, file another petition under Section 75(a-r).

None of the cases cited in appellant's opening brief deal with the question presented on this appeal, or support the assignment of error upon which appellant relies.

Two of the authorities cited in appellant's brief, the cases of *In re Neumann,* 12 Fed. Supp. 427, and *McKeever v. Finance Co.,* 80 Fed. (2d) 449, merely recognize and uphold the statutory right of a petitioner to an adjudication in bankruptcy, following proceedings for composition, but nothing is said or determined by the court in either of said decisions which upholds the claim that a debtor may, at his election, file successive petitions under Section 75(a-r).

In re Epstein, 12 Fed. Supp. 450, cited by appellant, was an ordinary bankruptcy case, and decides nothing contrary to the ruling of the District Court in the present case.

There is no analogy between the case of *Phoenix Bank v. Ledwidge,* 86 Fed. (2d) 355, in which the court decided against the debtor, and the present case. On the other hand the distinction is manifest from a cursory reading of the decision in said case. There, the first petition was filed under the original Frazier-Lemke Act of March 3, 1933, and the second petition was filed under the amended Act of 1935; and in its opinion the court said:

> "The reason for instituting the new proceeding was obviously to take advantage of the amendment of August 28, 1935, which substituted a new subsection (s) for the one declared unconstitutional by the Supreme Court in Louisville Joint Stock Land Bank v. Rudford."

We respectfully submit that the statutory mode should be the gauge of the farmer debtor's procedure and relief under this emergency legislation, and that the order appealed from should be sustained upon the ground that the statute did not authorize the debtor to file a second petition under Section 75(a-r) under the circumstances shown in this case.

II.

THE ORDER GRANTING THE MOTION AND DISMISSING APPELLANT'S PETITION WAS PROPERLY MADE BY THE DISTRICT COURT UPON THE GROUND THAT THE PROCEEDING WAS NOT IN GOOD FAITH, BUT WAS FILED FOR THE PURPOSE OF DELAYING AND HINDERING HER REMAINING CREDITORS.

One of the grounds specified in appellees' motion for dismissal was:

> "4. That the petition filed herein by said debtor under Section 75(a-r) was not filed in good faith, and was filed for the purpose of delaying and hindering her creditors."
>
> (Transcript, page 11.)

The following facts were stated in the affidavit filed in support of appellees' motion for dismissal, viz.:

> "That said debtor, after filing the foregoing proceedings under Section 75, as amended, of the Bankruptcy Act, No. 6575, and prior to said decision and order of Hon. Michael J. Roche, District Judge, entered on the 15th day of June, 1936, out of the cash listed in the schedule of her assets, filed with said original petition under Section 75, paid the debts due and owing to certain

creditors of said debtor whose claims were listed as liabilities in Schedule A filed with said original petition under Section 75, and said creditors thereby received a preference over the creditors represented herein by affiant;

"That the value of the assets of said debtor, as affiant is informed and believes, is greatly in excess of the value shown by Schedule B, attached to the petition herein; that the total value of the debtor's assets, according to a fair and reasonable value of same, exceeds the total amount of liabilities; and affiant is informed and believes, and upon such information and belief hereby deposes that the petition of the debtor herein was filed for the purpose of delaying and hindering the creditors named in the foregoing motion, and that said petition was not filed in good faith."

(Transcript, page 15.)

No counter-affidavit was filed, and there was no denial of said averments of fact.

With such a record, it should be sufficient here to cite the rule that this court does not review questions of fact on appeals from proceedings in bankruptcy.

In re Harris, 78 Fed. (2d) 849.

Said rule has been applied to the question of the debtor's good faith in filing a petition for composition or extension.

In re Augustyn, 87 Fed. (2d) 577.

In said case, which arose under Section 74, the court said:

"The question of good faith is a fact question, the determination of which this court will not disturb if there is substantial evidence support-

ing the conclusion of the lower court and there appears no abuse of discretion."

Opinion, 78 Fed. (2d) 579.

On the merits, we have shown in our statement of the case, supra, how the facts set forth in the debtor's schedules corroborate the charge that appellant paid some of her creditors in full before the dismissal of the first proceedings; and that they also show that the sum of $1862.99, out of the cash listed in the first schedule of assets, was not accounted for in the schedules filed with the second petition.

Irrespective of any element of contempt, the payment in full of the claims of some of her creditors and the omission to pay any of the claims of appellees was sufficient evidence of the debtor's lack of good faith to warrant the order of dismissal.

As to the other matters stated in the affidavit, and not contradicted, support may also be found in a comparison of the schedules filed by appellant.

From the schedules filed with the first petition it appeared that the petitioner's assets exceeded her liabilities. (Transcript, pages 21-23.)

When the schedule of assets filed with the second petition is examined it will be found that the first two parcels of real property are listed as of much lower value than was given for the same lands in the first petition (Transcript, pages 6, 21-22), and no value is listed for the "Smith Place on Stillwater", which was valued in the original schedule at $2000.00 (Transcript, page 22), but is actually worth $7500.00,

as was stipulated before the Conciliation Commissioner.

Thus it is made to appear by the later schedules that the liabilities greatly exceed the assets. Part of the reduction of assets is due, of course, to the change in the item of cash from $5000.00 to $2156.65.

Between November, 1935, and June, 1936, there was no general decrease in land values or farm prices, and the change in values set forth in the debtor's second petition may properly be interpreted as a deliberate attempt to make it appear that petitioner was bankrupt, and our affidavit, to the effect that the debtor's assets are greatly in excess of the value shown by Schedule B, is actually supported by the debtor's first verified petition.

In regard to the "Smith Place on Stillwater", it will be noted that appellant, in her second petition (Transcript, page 7), lists same, without valuation, as having been "set aside as a Probate Homestead by the Superior Court in and for the County of Shasta".

Having thus brought this matter into the record, we believe it is proper for us to point out here that said proceeding was another instance of the debtor's disregard and contempt of the jurisdiction of the bankruptcy court. The records of the Superior Court show that the application for said probate homestead was filed on March 11, 1936, while the first proceedings were pending in the District Court, and the order setting apart the homestead was filed on June 8, 1936.

The Superior Court was without jurisdiction to make said order.

Security etc. Bank v. Superior Court, 12 Cal. App. (2d) 140;

Harris v. Pacific Mutual etc. Co., 6 Cal. (2d) 384;

Silberblatt v. Forcey, 11 Fed. Supp. 484.

There was also presented to the District Court, in the argument on this feature of the case, the point that the debtor's second proposal of compromise and extension to creditors, dated August 31, 1936 (Transcript, pages 28-31), was not reasonably calculated to effect a debt liquidation.

In said proposal the appellant offered to settle the claims of the remaining unsecured creditors at 66⅔rds cents on the dollar, and offered to pay "in full liquidation" of the liens against the real property the appraised value of same, to be thereafter ascertained, provided she should have three years within which to pay said amount to the bank; and at the end of said period, if she failed to pay, the bank might take the property, provided it would agree *that it would not take a deficiency judgment.* Other details of the proposal, in line with provisions contained in Section 75(s), need not be mentioned here.

In brief, the debtor proposed that she should enjoy for three years all the advantages conferred upon the debtor by Section 75(s), and, *in addition,* that she should have a guarantee that the bank, after waiting three years, would waive its right to a deficiency judg-

ment in case it should finally have to take the property on foreclosure.

> The debtor's proposal of composition with creditors should contain "an *equitable* and feasible method of liquidation", and be *for the best interests* of the creditors, as well as his own.
>
> *In re Schaeffer,* 14 Fed. Supp. 807.

> "Certainly no debtor, acting in good faith, could reasonably expect acceptance by his creditors of a proposal fixing an extension or composition substantially more favorable to him and less favorable to creditors than the terms of subsection (s)."
>
> *In re Vater,* 14 Fed. Supp. 631.

It is respectfully submitted that the order appealed from was justified upon the ground of lack of good faith on the part of the debtor.

III.

THE PETITION WAS INSUFFICIENT IN LAW IN THAT IT DID NOT CONFORM TO THE GENERAL ORDERS IN BANKRUPTCY.

Subsection 9 of General Order No. 50(L) provides that in cases where an administrator files a petition under Section 75 he shall file with his petition certified copies of certain records of the probate court, including "a copy of an order of the probate court authorizing him to file the petition".

As the transcript shows, none of the required papers were filed with the petition in this case, which was

filed by appellant individually and as administratrix of the Estate of Charles Lemm, deceased; and the fact is that no order authorizing said administratrix to file said petition had ever been made in the probate court.

In the affidavit filed in support of the motion to dismiss (Transcript, page 16), it was shown that probate proceedings were then pending in the Superior Court of Shasta County, and that the petition was filed in disregard of the jurisdiction and authority of the probate court.

As we have shown above, there was no contradiction of said affidavit.

General Orders in bankruptcy have the force and effect of law.

Sabin v. Blake-McFall Co., 223 Fed. 501;
In re Gerber, 186 Fed. 693.

We respectfully submit that the order of the District Court should be affirmed.

Dated, Redding, California,
June 28, 1937.

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